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DEPT PASS AID/ANE, OPIC, AND TDA
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SUBJECT: Afghanistan: Aynak Copper Deposit -- Phelps Dodge Considers Bid

REF: A) Kabul 1173 B) Kabul 1172.

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Please protect accordingly.

This is an action request - see para 2.

¶1. (SBU) Summary and Action Request. The competitive bidding process for the Aynak copper deposit is moving forward. Over the last two weeks, the GOA hosted all nine short-listed prospective bidders, including the US natural resources company Phelps Dodge, to do rounds of GOA Ministries, review the data and visit the site. Company representatives told the Embassy that the data shows that Aynak is indeed a world class deposit in quality and size. Whether Phelps Dodge submits a bid will be a decision made by the company's top management. The visiting team confirmed that the bidding process has been fair and transparent to date, but Phelps Dodge feels a bit out of its element competing against regionally active Chinese, Russian, and Kazak companies. In Phelps Dodge meeting with Embassy staff (ECON, AID and ARG) on April 10, DCM requested that Embassy be informed immediately if there was any hint of non-transparent actions; we would raise it with the GOA at high levels. In spite of the GOA stated preference for bids to include an on-site smelter operation, Phelps Dodge will not offer a smelter operation, because there is excess world smelter capacity.

¶2. (SBU) We underscored the importance of the Aynak project for Afghanistan's economic development, and offered full support, including appropriate advocacy assistance. Together with other donors we will also continue to monitor the process. Ref A action request sought Washington support in urging World Bank management to extend its existing technical assistance on the Aynak project to include services of a recognized international legal firm familiar with mining transactions. Given the importance to Afghanistan of the Aynak project as a precedent for foreign investment and future development of its natural resources, post reiterates this request.

End Summary and Action request.

¶3. (U) Representatives from Phoenix-based natural resource company Phelps Dodge briefed DCM and Embassy staff from ECON, AID and Afghan Reconstruction Group on April 10 regarding the company's interest in bidding for the large Aynak copper deposit near Kabul. The Phelps Dodge team was in Afghanistan at the invitation of the Ministry of Mines (MOM), which invited all nine short-listed international companies during a two-week period to meet with GOA officials, visit the site and review the available data. We underscored the importance of the Aynak project for Afghanistan as a direct and indirect boost to the economy as well as a precedent for future large and long term projects.

Due Diligence

¶4. (U) The Phelps Dodge team's goals for its Afghanistan visit were to conduct due diligence on the deposit and to sell itself to the GOA. They confirmed that the available data -- much of it compiled by the Soviets during the 1970s and 1980s -- established that the Aynak is a world class deposit, both in its size and in its ore concentration. Aynak's 2.3-2.5 percent concentration is a number of times higher than the 0.4 percent average of Phelps Dodge's world-wide copper reserves.

Marketing

¶5. (U) To champion its own credentials for the bid, Phelps Dodge met or were scheduled to meet a wide spectrum of GOA officials, including Minister/Deputy Minister level officials in the Ministries of Mines, Finance, Justice, Interior, Energy, Foreign Affairs,

KABUL 00001468 002 OF 003

Economy, Commerce and Industry and the National Environmental Protection Agency. The meetings, arranged by MOM, were fruitful and positive, according to the Phelps Dodge officials.

Transparency

¶6. (U) The Phelps Dodge team said it believes the bidding process had been transparent so far. The World Bank-funded American consultant Gustavson Associates is guiding the bidding process with heavy emphasis on fair and transparent procedures. Underscoring the importance of transparency not just for the Aynak project but also for Afghanistan's investment climate and investor confidence, the DCM requested that Embassy be informed immediately if there was any hint of non-transparent actions; we would raise it with the GOA at high levels.

To Bid or Not to Bid

¶7. (SBU) Whether Phelps Dodge submits a bid will be a decision made by the company's top management, based on the recommendation the visiting team is preparing. The team reiterated that its assessment is in the early stages and it is by no means a given that it would recommend a bid. That said, the team implied that the size and quality of the deposit is such that it would be hard to walk away from it despite the very real infrastructure (transportation, power) and security concerns. (Note: Phelps Dodge noted that it is in the process of being acquired by Freeport-McMoran and it is difficult to predict whether this would impact their bid. End Note.)

Timeline

¶8. (SBU) Bids, originally due by 14 May 2007, are now due at the end of May. An inter-ministerial assessment team will then select the winning bidder and commence negotiations. The bid procedures call for a two-month negotiation period. Econ Counselor underscored the importance of both sides feeling they received a fair deal. In particular, if there is a perception among the Afghan people that a multinational company has hoodwinked the Afghan Government and

stolen their national assets, it would significantly damage the prospects for future projects involving foreign investment. (Note: In Ref A, Embassy requested Washington agencies to approach the World Bank to support funding for services of a recognized international legal firm familiar with mining transactions to advise MOM in its negotiations with the winning bidders.) Once the contract is signed, the winner can begin site work, including feasibility studies. If Phelps Dodge emerges as the winner, it would make a final corporate decision on whether to move forward with the project in 2009, based on two years of in depth analysis and feasibility study. GoA would like to see production begin as early as 2012, a timeline characterized as overly ambitious by Phelps Dodge; the company estimated 2014 or later to be a more reasonable timeframe for production.

Sizing up the Competition

¶9. (SBU) While satisfied with the transparency of the process, the team conceded that Phelps Dodge feels a bit out of its element. The cast of bidders on this project involves Chinese, Russian, and Kazak companies against whom Dodge not used to competing. One concern is that these companies may be willing to make their bid more attractive by including promises and commitments they cannot realistically keep, e.g., a 2-3 year production timeline. Phelps Dodge, which must meet western business practices and protect an internationally recognized name, vows only to promise what it knows it can deliver. The Phelps Dodge officials also noted that there is

KABUL 00001468 003 OF 003

a measure of subjectivity innate to the assessment of bids such as Aynak. It is hard to predict how the selection committee would assess the economic and social benefits accruing from each bid.

¶10. (SBU) An issue of particular concern is a provision in the model contract that allows the terms to be re-opened every five years. This practice, according to the company, is not consistent with international standards. This is not, however, in its view an issue of immediate concern, because it will only arise in the negotiations stage with the winning bidder. A possibly more significant Phelps Dodge concern is the GOA preference for bids to include an on-site smelter operation. Phelps Dodge's bid will not include a smelter operation because there is excess smelter capacity world wide and international companies have been shutting down some smelter operations.

Synergy of Efforts

¶11. (U) The Phelps Dodge team asked about the prospects of donor funds being directed into infrastructure that could benefit the project. The DCM indicated that roads and power are high priorities for the USG, the GOA and other donors. The huge ongoing effort to build the power systems and road networks should directly or indirectly benefit the Aynak project, no matter which company won the bid.

Advocacy

¶12. (U) The Phelps Dodge team appreciated the DCM's offer of the US Mission's full support to Phelps Dodge, including advocacy assistance as necessary. Econ Counselor outlined the established Washington advocacy procedures and documentation requirements, notifying that with just one American company in the fray, the USG can launch a more aggressive advocacy campaign for Phelps Dodge.

Comment

¶13. (SBU) Embassy is encouraged that the competitive bidding process for Aynak is going forward smoothly and transparently. The project is important to Afghanistan from many angles. It will generate significant revenues for the GOA, direct and indirect employment and income for Afghans. It will be the first large, long-term international mining project in Afghanistan. If it goes well, it

would boost investor confidence and be a positive precedent. It is crucial, therefore, that the GOA get this right. Together with other donors we will continue to monitor the process and try to ensure it remains on track. We are pleased that Phelps Dodge is seriously considering a bid, not only because it is an American company but also because it would be comforting to see a project of this significance for Afghanistan run by one of the world's leading and most reputable natural resource companies.

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